



April 3, 2009

Via email: [regcomments@ncua.gov](mailto:regcomments@ncua.gov)

Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, VA 22314-3428

Re: Advanced Notice of Proposed Rulemaking to 12 CFR Parts 704

Dear Ms. Rupp:

On behalf of the management and Board of Credit Union 1, I would like to take this opportunity to comment on the recently issued Advanced Notice of Proposed Rulemaking (ANPR) to 12 CFR Part 704.

We appreciate the opportunity extended by the Board and staff of NCUA for allowing all natural person credit unions the opportunity to work collaboratively in this evaluation process.

#### **Background**

Credit Union 1 is \$550 million in assets and has 80,000 members served through 26 branch offices located in Illinois and Indiana. Membership at Credit Union 1 is multi-faceted consisting of government, university, industry and geographic common bonds. As a not-for-profit financial cooperative, Credit Union 1 is unique, yet similar, within the financial services market place.

Significant factors contributing to our uniqueness, Credit Union 1 is a member of both Members United Corporate Federal Credit Union (Members United) as well as Corporate One Federal Credit Union (Corporate One). **The services provided by the corporate credit unions: settlement; aggregation; investment/liquidity management are not unique. Rather, the manner in which those services are provided is unique. This uniqueness must be preserved.**

During the past 24 months, our members directed more of their deposit and investment dollars to the safety of accounts at their credit union. This flight to quality increased the balances Credit Union 1 held on deposit at Members United. In an effort to reduce the concentration of deposit dollars at one corporate credit union, Credit Union 1 opened an account at Corporate One.

We utilize both corporate credit unions and view each relationship with great value and respect. Value is derived by the unique structure of a member-owned financial cooperative. Respect for the

knowledge of payment systems, investment alternatives and member service that benefit our credit union and eventually our members.

The ability to utilize more than one corporate credit union not only reduced the concentration risk for Credit Union 1, but also increased the accessibility to products and knowledgeable experts operating for the benefit of their member. An example of competing products, Credit Union 1 selected Check 21 (ACE) image processing offered through Corporate One. We reviewed products offered by both Corporate One and Members United and chose the product that best fit our needs.

However, Members United remains the corporate credit union that facilitates settlement for ACH, wires, member share drafts and VISA/ATM. Members United also provides currency delivery services at a better price than we could negotiate for a single credit union. Finally, both corporates provide brokerage services whereby trustworthy competitive bids can be obtained for investment purchases.

### **Current Situation**

Currently, the corporate credit union system is under pressure of an extended and severe economic recession. Adding to this pressure is an inordinate level of investment in asset-backed investment securities – primarily backed by mortgage products. This concentration in mortgage related asset-backed securities is further complicated by an overreliance on rating services that did not adequately or accurately reflect the risk contained in the individual mortgages supporting the pools.

Corporate credit unions were under capitalized for both the concentration risk and credit risk. This applies to corporate credit unions with expanded investment authority and to those without the expanded authority. Those corporate credit unions without expanded investment authority were undercapitalized for their investment in US Central's balance sheet.

### **Response to the ANPR**

We have attended presentations by both Corporate One and Members United concerning this ANPR. Also, we have read both corporate credit unions response to this ANPR. Based on the importance of protecting the unique corporate credit union structure and to lend support for position which we are in agreement with their responses, we felt compelled to respond directly to this ANPR.

*Payment system.* Credit Union 1 fully utilizes the payment systems managed by the corporate credit unions. The security provided by member-owned and controlled entities with the primary objective of returning to the member – natural person credit unions, minimize security breach risks. Further for-profit payment system providers goal to return to their shareholders, could produce instability in service to our members caused by merger or bankruptcy of a for-profit provider.

*Liquidity and liquidity management.* Credit Union 1 values the liquidity functions of corporate credit unions. Further, we believe this is a natural service to be provided with settlement/payment systems to enhance cash or treasury management. By splitting these two



functions to separate entities, natural person credit unions would need additional layers of cost and complexity through ACH transfer or wire activities for settlement.

Structure of an entity and tools to manage/supervise/oversee such an entity is also part of this ANPR. The question is valid and a task force of NCUA, NASCUS, CUNA and both natural person and corporate credit union representatives could address this topic both reasonably and rationally.

Field of Membership Issues. We have benefited from the ability to join more than one corporate credit union. As previously mentioned, Credit Union 1 was able to reduce concentration risk by allocating excess liquidity between the two corporate credit unions. Further, action by NCUA to guarantee all deposits in corporate credit unions allowed Credit Union 1 to return excess liquidity to the corporate credit unions in order to stabilize the corporate credit union system.

As previously mentioned, the concentration of corporate credit union assets in mortgage related securities that proved to be much less liquid and risk-reducing than modeled is the primary problem in corporate credit unions. Further, the level of capital at each corporate credit union proved to be inadequate and proved to magnify the understated risk assessment of several corporate portfolios

Therefore, we support the competition provided by national fields of membership. We believe that a structure whereby corporate credit unions again become geographic assignments would be a mistake. The Federal Home Loan Banks (FHLB) is an example of geographic assignment which is not necessarily beneficial to their members at any given time.

The U.S. economy has proven to be robust overall, while at the same time, both over-heated and critically anemic in differing geographical sectors. Recently, the Midwest did not experience the phenomenal rise in real estate as compared to the Western and Southern states – also, the Midwest has not seen the dramatic subsequent free-fall in real estate values as those same sections of the U.S. Accordingly, a geographic corporate credit union could be fully extended in a growing territory and unable to meet lending needs of its membership, while another geographic corporate credit union could be struggling to provide service to its members. This is currently happening in the FHLB where Chicago is limited in its lending ability while Cincinnati has excess capacity. By the singular placement based on a zip code of the natural person credit union, the ability to manage liquidity could be critically impacted.

Expanded Investment Authority. Again, we believe the misjudged concentration risk complicated by the undercapitalization of balance sheets were the source and contributing factor of the current situation facing corporate credit unions.

Expanded investment authority was and remains a beneficial endeavor and service provided by the unique structure of corporate credit unions. Providing brokerage services from within the

credit union system between various competing corporate credit unions lends safety and security to natural person credit union investment portfolio management.

Oversight by corporate credit union boards and asset/liability management committees in conjunction with appropriate policy formation and regulation of concentration risk levels must be evaluated or re-evaluated. We believe this would prevent excessive risk-taking. Further, regular presentations of corporate investment portfolio reviews should be conducted with the natural person membership. Both Members United and Corporate One have led in this “transparency” of financial reporting.

Structure; two-tiered system. We have listened to presentations and discussion on this topic. Our position is that all corporate credit unions were exposed to excess concentration risk, inadequate credit risk and liquidity risk modeling, and under-capitalization at US Central Corporate Credit Union. However, we would recommend that a task force of NCUA, NASCUS, CUNA and both natural person and corporate credit union representatives could address this topic both reasonably and rationally.

Core Capital. The capital – core capital, proved to be insufficient at the corporate credit union level for the excessive concentration and liquidity risk in the portfolios of most corporate credit unions. Even corporate credit unions without expanded investment authority had too little capital for the risk at US Central from the investment portfolio dominated by mortgage-related asset backed securities.

Core capital must be increased. However, many natural person credit unions would be hard pressed at the present time to either invest more capital in corporate credit unions or to risk more of their existing capital which is under pressure from the current crisis. Credit Union 1 whole-heartedly disagrees with the position of expanding capital investment from outside the credit union system including but not limited to outside board member representation. The unique structure of financial cooperatives and financial cooperation must be preserved.

Membership capital. The current financial crisis has both occurred and magnified in the past 24 months. A three-year notice capital requirement has proven more than adequate in preventing any type of run at a corporate credit union relating to membership capital shares. As the risk at corporate credit unions became known, liquidity flowed out of the corporate credit union system, but member capital shares could not.

We disagree with the concept that “...any withdrawal of membership capital be conditioned on the corporate’s ability to meet all applicable capital requirements following withdrawal.” This provision or condition would prevent a natural person credit union from sufficiently exercising its fiduciary duties to their membership. Should the natural person credit union desire to reallocate resources or exposure away from a corporate, this provision would be a barrier and



with such optionality, could not be adequately accessed or reported by the natural person credit union.

*Risk-based capital and contributed capital requirements.* Capital investment should be required to join any credit union –corporate or natural person credit union. What constitutes a capital investment or sufficient capital investment is a valid question. As many are discovering presently, capital is at risk – whether Membership Capital Accounts (MCS) or Paid In Capital (PIC). The level of capital appears to be adequate except for the exposure to US Central Credit Union. The new look for the corporate credit union system will be based on the capital that remains after the excessive concentration and illiquidity of the asset-backed mortgage securities is resolved. There may need to be a recapitalization period to restore the entire credit union system.

*Permissible Investments.* We believe that corporate credit unions can and should have expanded investment authority given adequate policies addressing concentration risk and reliance on third-parties for ratings and due-diligence. NCUA should prohibit certain categories of investment vehicles as cited in the ANPR. However, given the imagination and ingenious ability of securities designers, a framework of permissible investments must be determined. Here, preserving the oversight of corporate credit unions by NCUA specialists is imperative.

*Credit Risk Management.* We concur that failures by Nationally Recognized Statistical Rating Organizations (NRSROs) contributed to the current situation at corporate credit unions. However, overreliance on any third party is more of a concern with the risk attitude or environment at corporate's. A structure as described in Corporate One's response to this ANPR item number 7 appears appropriate and reasonable.

*Asset Liability Management.* We believe that modeling NEV, income simulation, net interest income and stress testing are indicative of both safety and soundness. As stated in Corporate One's response item 9 "[a] principle-based regulation that uses the supervisory examination process to determine the adequacy of risk controls in a corporate credit union will lead to greater safety and soundness."

*Corporate Governance.* We believe that the unique structure of our credit union industry is strengthened by the dedication of our volunteers. Board members are the ultimate example of dedicated volunteers. Again, our premise is that a failure to manage concentration risk and understating the illiquidity of asset-securities due to market stresses and underlying credit issues contributed to the current situation.

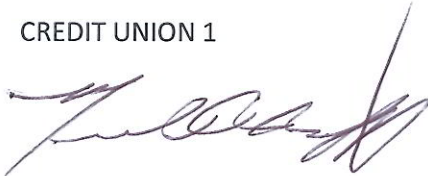
Accordingly, we do not support compensation for board members above reimbursement for travel and conferences are appropriate. We do not generally support term limits as a means to facilitate the long-term goals of the financial cooperative – whether corporate or natural person credit union. Finally the concept of "outside director" is interesting. However, without

compensation for the fiduciary risk undertaken, we do not think this is a viable alternative. Increasing board member knowledge and involvement are imperative to preserving the unique structure of corporate credit unions.

In conclusion, Credit Union 1 appreciates the opportunity to respond to this ANPR. Our hope is that a framework to maintain the unique structure of corporate credit unions can be developed through the dialogue provided by the NCUA in this process.

Sincerely,

CREDIT UNION 1

A handwritten signature in dark ink, appearing to read "Michael R. Radliff", with a stylized, sweeping flourish extending from the end.

Michael R. Radliff  
EVP/Chief Financial Officer